

THE STATE OF NEW HAMPSHIRE
Before the
PUBLIC UTILITIES COMMISSION

Public Service Company of New Hampshire)
Transition and Default Service Rates -) DE 04-177
Return on Equity)

July 12, 2005

OFFICE OF CONSUMER ADVOCATE'S
OBJECTION TO PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE'S
MOTION FOR REHEARING OF ORDER NO. 24,473

The Office of Consumer Advocate (OCA) objects to Public Service Company's (PSNH's) Motion for Rehearing and in support of its objection states as follows:

1 PSNH raises several reasons for its request that the Commission rehear Order 24,473. PSNH claims that the Commission's Order misapplies PSNH's risk premium and reaches a mathematically incorrect result; that the approved cost of equity is confiscatory; and that the Order is unjust, arbitrary and unreasonable in that it relies on only one methodology, applies a mathematical adjustment without reasonable judgment, fails to compensate investors and fails to balance investor and ratepayer interests.

2. Miscalculation. Although the calculation contained in the Commission Order appears incorrect as it relates to the 1/3-2/3 issue, there was ample evidence in the record to support a significant reduction to the PSNH witness's risk premium. The OCA witness provided evidence that indicated PSNH's generation risk premium analysis was

unreliable for several reasons. (see pages 38-42 of Exhibit 14, Hill testimony Exhibit)

Generally, Morin's generation risk premium is based entirely on beta as a measure of risk, which has been shown to be inaccurate. The PSNH witness uses gas distributors as proxies for electric T&D companies' risk, but in another jurisdiction testified that gas distributors have risk equal to fully-integrated electrics. The PSNH witness used oil and gas exploration companies as proxies for fully-integrated generation operations with no proof that their risk is similar. The PSNH witness failed to note that PSNH's generation fleet contains no nuclear units and, most important he failed to note that PSNH's stranded cost recovery effectively guarantees the recovery of all generation related costs, making its units considerably less risky than those of a normal integrated electric utility. Finally, the PSNH witness relies on an overstated market risk premium to estimate the generation risk premium. As noted at Exhibit 14 page 42 of OCA testimony, if the high end of the range of current market risk premium expectations is used, PSNH's risk premium would decline to 33 basis points--very similar to what the Commission actually ordered.

In addition, when the OCA witness recalculated the numbers contained in the Commission's Order 24,473 using the Commission's three-stage DCF and the other assumptions contained in the Commission's Order, he obtained a lower number, 9.29%. As a result, if any miscalculation occurred it may well have moved the return on equity number in a different direction than claimed by PSNH, which only points up the weakness of relying solely upon an arithmetic exercise to determine the cost of capital.

3. Confiscatory Cost of Equity. The order does not require rehearing because it is confiscatory. The DCF has long been a primary determinant of the equity return allowed

regulated industries. It is a market-based return and indicates investors' current return requirements. Moreover, the Commission's determination of the cost of equity capital for a fully-integrated electric company at 9.23%, is at the upper end of the range of returns offered by both Staff and OCA and, thus is well within the range of credible evidence in the record. PSNH is purposely confusing earned returns with the cost of capital (just as the PSNH witness did in his testimony on the witness stand). What a company earns on its books of record is the result of many variables related to its operations (weather, management efficiency, cost of fuel, success or failure of unregulated operations). What investors require in order to invest in those companies is found in the market price of the firm, not the income statement. Therefore the cost of capital--the return that should be allowed (see Transcript, May 18, 2005, p. 210 lines 2-5), is the cost of capital. The earned return is equivalent to the cost of capital only by happenstance. If the current level of earnings by utilities (about 10% to 11%) were equal to their cost of capital, then the market prices investors are willing to provide would approximate the book value (earnings base) of those firms. It does not; the market price of electrics is currently about 60% higher than book value because those companies are earning accounting returns that exceed their cost of capital. In that case, basing an allowed return on the average earned return of utilities would clearly violate constitutional standards requiring consideration of customer interests because, in that situation, rates would be based on a return exceeding the cost of capital.

Long, long ago--prior to the advent of modern market-based equity cost estimation methodologies--regulators commonly set utility returns based on what

other utilities were earning. That practice disappeared with the ability to directly estimate the return investors require (the DCF). And it is only through the allowance of a return on equity equal to the cost of that type of capital that the interests of ratepayers and investors can be balanced with the needs of society. Today, what rate of profit another utility is allowed to earn under different economic and regulatory circumstances in another jurisdiction is simply not germane to the current cost of common equity.

If all other regulatory bodies were unduly harsh, causing the collapse of regulated industries, should this Commission follow suit? If all other regulatory bodies were unduly generous, enriching stockholders at ratepayer expense, should this Commission blindly follow suit. Or, should this Commission review the evidence and make its own decision?

4. Arbitrary Decision. The level of return ordered by the Commission is far from "arbitrary." The company can cite allowed returns that are higher. OCA cited allowed returns for regulated entities that are lower. OCA also cited current evidence related to the latest research in the field of financial economics that indicate that investors' required returns (the cost of equity capital) for stocks in general is below 10%. Therefore, for utilities an allowed return of 9.6% is quite generous. The Company fails to discuss the current research, and chooses instead to rely on only the higher numbers. Just as the PSNH witness, in his DCF analysis throws out the low numbers and retains the high numbers in a statistically untenable manner, PSNH's claim that the Commission's ROE determination here is "arbitrary" is based on a myopic view of the evidentiary record. Apparently, PSNH only sees ROE results above 10%, the others are written in invisible ink.

5. The 9.6% decision is well within any rational "zone of reasonableness," evidenced in the record in this proceeding.
6. Efficient management. If the Commission is going to shave PSNH's result up for "efficient management", it should also shave downward for the consideration of reduced risk related to the recovery of stranded generation costs. (see Transcript May 17, 2005, p. 160-63 discussion regarding equity risks equivalent to bonds). So, PSNH has done a good job, aren't they SUPPOSED to do a good job? Does PSNH expect a reward for doing what they are supposed to do? Can they show that they have gone above and beyond the call of duty? Is there any evidence to that effect in the record?
7. Formulaic analysis. While the Commission's analysis is certainly formulaic, the result is supported by the DCF analysis of every single witness in the case. (see p. 72 of my testimony--if Morin's DCF were balanced, that is threw out statistically high and low results, his DCF result in this proceeding would equal 9.4%) The Commission's equity return recommendation is also supported by OCA's corroborative methodologies (CAPM, MEPR and MTB) all of which show that the cost of equity is well below 9.6%.
8. Due process regarding the 3-stage DCF. The Commission's 3-stage DCF is the same as that presented by the Staff witness. PSNH had ample opportunity to cross-examine the ins and outs of that methodology when the Staff witness was on the stand and elected not to do so.
9. Commission's DCF lacks "independent judgment." The independent judgment is contained in the record evidence in which three different experts come up with similar DCF results. How much more independent confirmation does one need?

10. The use of the OCA sample group with another model does not violate the result obtained. Simply because the Staff witness elected to apply a particular parameter to her sample group selection does not mean that the sample group selected by Hill is unreasonable and PSNH has not argued that it is. Therefore, if the companies are of reasonably similar risk to PSNH, then because there are ten companies in the sample group the data anomalies (if there are any) will cancel each other out and the result will be accurate. Again, the Commission's DCF result is corroborated by all three experts.

11. All the hyperbole over the Commission's own DCF calculation being out of the record and limiting due process is a red herring. The Commission, on its own, reviewed the evidence, took what it believed to be the most reliable data and methodology and used it to calculate a cost of equity estimate. That estimate is similar to the DCF (and other results) in the record. All of the Company's arguments would be moot if the Commission had said "we've reviewed the evidence and believe 9.42% to be the current cost of equity for fully-integrated electrics." The Commission, in its attempt to openly quantify its decision, has not prohibited the Company's due process in any way.

12. Imprudence risks. The only evidence in the record that the Company could be exposed to imprudence risks supports the Commission's finding that it is miniscule.

WHEREFORE, the OCA requests that the Commission clarify its Order by making clear that the PSNH cost of equity of 9.63% is reasonable and is fully supported by the record in this proceeding.

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Respectfully Submitted,

F. Anne Ross, Esq.
Consumer Advocate
21 South Fruit Street
Suite 18
Concord, NH 03301
603-271-1172

CERTIFICATE OF SERVICE

The undersigned certifies that she mailed copies of this motion by first class mail to all of the parties on the Commission's service list for this docket on July 12, 2005.

F. Anne Ross